

\$50.00 ANNUALLY
40 Letters Per Year

Dow Theory Letters

"The Market as Interpreted under the Dow Theory"

RICHARD RUSSELL
125 East 93rd Street
New York City 28

Registered with the Securities and Exchange Commission

All Rights Reserved

November 23, 1960

Number 124

Page 1

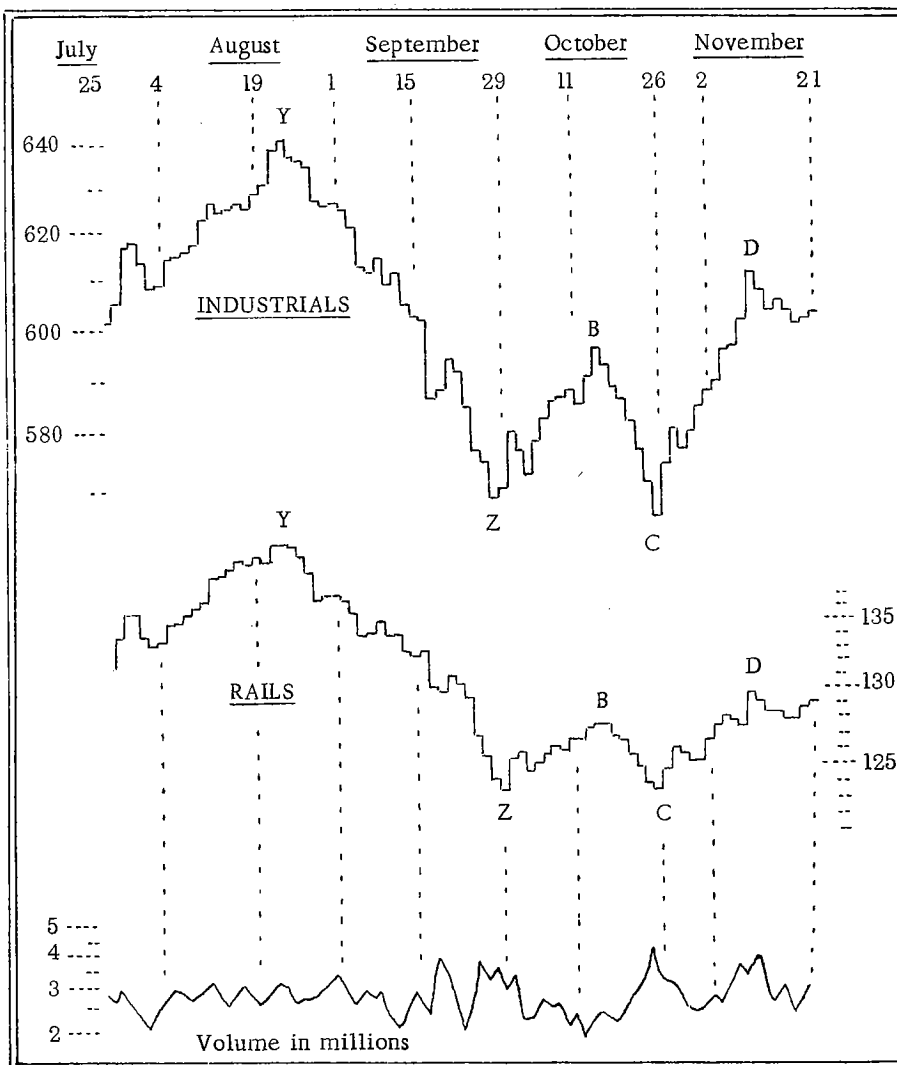
THE MARKET The rise of the short interest to 4.13 million shares has stirred up a good deal of excitement among the "technical fraternity". However, the fact that the market has gathered a good-sized short position is not important unless those shorts are pitted against the primary trend. A large short position in a bull market implies that a great deal of misguided bearishness is "arguing" with the primary tide. Sooner or later a bull market will drive the shorts to cover. But during a bear market the shorts can be right. Fundamentally, values are decreasing in a bear market, and speculation for future delivery at lower prices (during a bear market) is speculating with the tide. In the latter case the short position is not an important technical indication. Letter 115 discussed the 5.5 million short position of May, 1931. This large group of bears proved to be absolutely correct during the subsequent fourteen months (until July, 1932).

On November 10 the two Averages touched peaks of 612.01 and 129.75 respectively (D on chart). Since then the two indicators have retreated slightly, with volume tending to diminish as prices worked lower.

The Industrial Average has formed a definite minor downward zig-zag, and the Rail Average has kept about "in gear" with the senior Average. A joint bettering of the D points on increasing volume would imply an extension of the secondary (upward) reaction. Conversely, a persistent refusal by one or both Averages to hurdle the D points would be the first hint of danger. It is well to remember that volume can be extremely deceptive during secondary reactions. Readers may remember that bullish inferences based on volume during the last secondary proved to be incorrect.

Bulls on the market can point to the increase in the short interest total, the generally high rate of odd-lot shorting, the recent few days of odd-lot selling on balance (more odd-lot sales than purchases), and the ability of the market to rally or hold in the face of poor business news.

Bears can call attention to (1) that principle of Dow Theory which states that the primary trend is taken to remain in force until



reversed by an authoritative counter-signal, (2) the sharpness of the C-D rally as compared to the gradual decline since D, (3) the ratio of the short interest to the average daily volume, which is still neutral at 1.41, (4) the rapid increase in optimism on the part of technicians and investment services (bears are hard to find again), (5) the frequent comments about the "double bottom of September-October", and (6) the widespread talk of a "business upturn in the spring of 1961" (the "mild recession" view is obviously open to "contrary opinion").

Page 2

All market arguments are settled by the passage of time. Such settlement, of course, requires the use of an extremely scarce commodity, patience. In the meantime, the primary trend must be considered down. The secondary trend turned up when both Averages bettered their preceding peaks at B.

DOW'S THEORY has been used successfully by businessmen and investors since the turn of the century. The Theory is based on the premise that the Averages contain the combined knowledge and wisdom of millions of stockholders, traders and businessmen. Over a period of sixty years the vision of the Averages has proved superior to that of Presidents, presidential advisers, financial analysts, business leaders or any other group of men. Economists have never been able to swallow this bitter pill, for which reason a great deal of time is usually spent deriding each major forecast of the Averages. Last March the Averages signalled a bear market. Following this, indignant corporate leaders insisted that we were still in "the Soaring Sixties", Dow's Theory was thoroughly ridiculed and the warning of the Averages was dismissed as the croaking of "an ancient system". A few weeks ago (seven months after the bear signal) John F. Smith Jr., president of Inland Steel confessed to the American Institute of Steel Construction: "...my own score in estimating 1960 steel production a year ago is so bad that I have decided at all costs to avoid making a short-term forecast today. If pressed to do so I would suggest a moment of silent prayer and confine my forecast to mumbling about the rewards of hard work and clean living." He added that "...better forecasts a year ago could have saved all of us much grief and embarrassment."

Unfortunately, when primary reversals do occur most people are not ready for them. A bear market always seems to arrive at a time when the country is fully invested, while a new bull market usually finds the public devoid of stocks (and so, of course, they could not care less whether the market goes up, down or sideways).

Dow's Theory does not depend on bank credits, housing starts, failure liabilities, steel output figures or any other single indicator. It uses them all, and the "story" in the Averages takes into account the personal transactions of Mr. Hamilton Bolton and his banking statistics, Mr. Baxter and his gold, Mr. Drew and his odd-lots, John Magee up in Springfield with his stock charts and every other bull or bear who ever called a broker to put his money where his mouth was.

Many of the readers of these Letters sold part of all of their stocks in late 1959 and early 1960. Dow's Theory does not imply waiting for primary confirmation, and I have never read a single sentence by Hamilton or Rhea which even remotely suggested waiting for a bull signal before buying or waiting for a bear signal before selling.

In March, 1959, following the bear signal, the majority of advisers insisted that it was too late to sell stocks. But most of March's prices look attractive now, and I have not heard a blast at Dow's Theory since last summer. Toward the end of 1959 a few subscribers wrote to protest my selling advice. "What would we do with the money?" they asked. I could never understand the mental processes of a man who asked that question. Joseph Granville's new book (see Letter 123) contains an interesting section in which he lists (1) the price of the thirty D-J Industrial stocks on August 3, 1959 (at the bull market top), (2) the current market price for those stocks, and (3) the total gain or loss in dividends translated into years of income. I believe this study is one of the best answers to the question, "what would I do with the money?" Here is a part of that list brought up to date.

<u>STOCK</u>	<u>Price August 3, 1959</u>	<u>Price Nov. 1, 1960</u>	<u>Years of Dividend Income Lost or Gained</u>
Allied Chemical	\$126.75 (split)	\$49.25	7.4 years lost
Alcoa	110.25	65.50	37.5 years lost
American Can	45.50	32.50	6.5 years lost
American Tel.	80.13	91.50	3.3 years gained
Anaconda	64.00	42.25	11.0 years lost.
Bethlehem Steel	57.50	40.50	7.0 years lost
Chrysler	67.00	42.50	24.5 years lost
duPont	275.75	182.00	18.0 years lost
Eastman Kodak	95.63	102.50	3.0 years gained
General Electric	81.38	73.00	4.0 years lost

And on it goes. Remember, this is a "blue chip" list and the blue chips generally take their worst "beatings" in the last phase of a bear market. When Joe Granville compiled his original list a few months ago two-thirds of the Dow stocks were showing losses. The list looks worse today.

INTERNATIONAL MARKET MOVEMENTS History shows that all primary movements and most important secondary movements are international in scope. Our own bull market "topped" on July 8, 1959, when the two Averages established their last confirmed highs. Dow's Theory has a following in only one other country of the world (England); for this reason I doubt if anybody can accuse Dow Theorists of "knocking down world markets". Nevertheless, a few months ago (September) the West German stock average suffered a shattering drop of 20% in a period of one week. The Japanese market had its first violent "shakeout" some months earlier. British stock averages are now nearer the year's lows than the highs. The following excerpt is from a recent edition (November 9, 1960) of the Christian Science Monitor: "The 'Black Monday' of October 24 on the Italian stock market, which sent a shiver of apprehension through the financial world of Rome and Milan, will be remembered for some time. Some newspapers were foretelling that the sharp fall in stock market prices averaging over 10% in one day marked the end of Italy's economic boom..."

World economies follow world markets. There seems to be an increasing probability of an international automobile glut's developing, and one reads (last week) of 30,000 British auto workers' going on part-time schedules. At the same time Pierre Dreyfuss, president of France's Renault begs the Americans not to "drop the atomic bomb of a small car" on Europe. According to the New York Times (November 15), unemployment in Canada during the month of October jumped 46% above the same month last year to a total of 368,000. This, said the Times, was "...a post-war record for the month".

On top of all this the Russians are now adding their own brand of fuel to the international fires. My friend Eliot Janeway (the economist-writer) was one of the first to spot the coming trouble from Russia. In one of his recent reports he states: "Russia is extending and sharpening her oil marketing offensive; she is combining it with a new coal marketing offensive. This attack on the fuel economy of the Free World is coinciding with the spread of the U. S. Recession to Europe."

The purpose of the foregoing paragraphs is not to depress subscribers; it is (1) to underline the validity of the opening premise, namely, that all primary movements are international in scope, and (2) to illustrate the fact that newspapers tend to headline the good news and bury the bad news (how many of the foregoing items have you read about?)

POINT & FIGURE (P & F) I have received many inquiries over the last few years regarding the value of P & F charts. In general, I have found P & F charts to be useful in interpreting the action of individual stocks but of doubtful use in interpreting market trends. The accompanying chart of the D-J Industrial Average is known as a 5 point reversal chart. This means that each time the Industrials move a full five points up or down a new box is filled in on the chart. The X's represent rallies; the O's represent declines, and each row of X's or O's occupies a new vertical line to the right. If Industrials were to fluctuate within a 4 point area for months, however, nothing would appear on a 5 point reversal chart. Any size reversal may be used (i. e. 1/2 point, 1 point, 3 points), but usually the higher the price of the stock or the Average, the larger the reversal span used. Obviously, a 5 point reversal chart will show a great concentration of movement, whereas a 1/2 point reversal chart of the same action might cover ten times as much chart space (since it would include many minor movements).

P & F takes only one factor into consideration - price movement. It is the opinion of P & F chartists that nothing exists without price; therefore price movement produces volume. Both merely work through time. Personally, I prefer seeing time and volume on a chart and consider them both useful in interpreting price movement. But because of their peculiar property of concentration, P & F charts often give one a definite "feel" for the big picture.

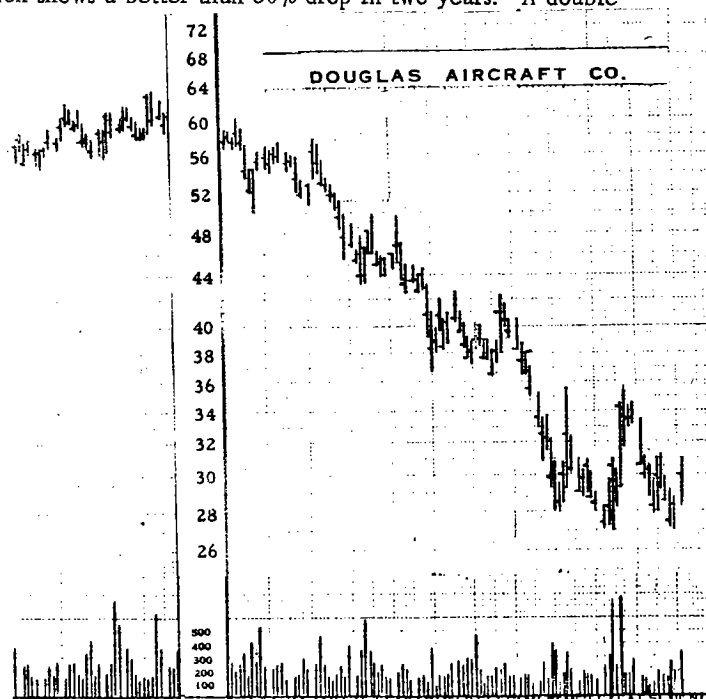
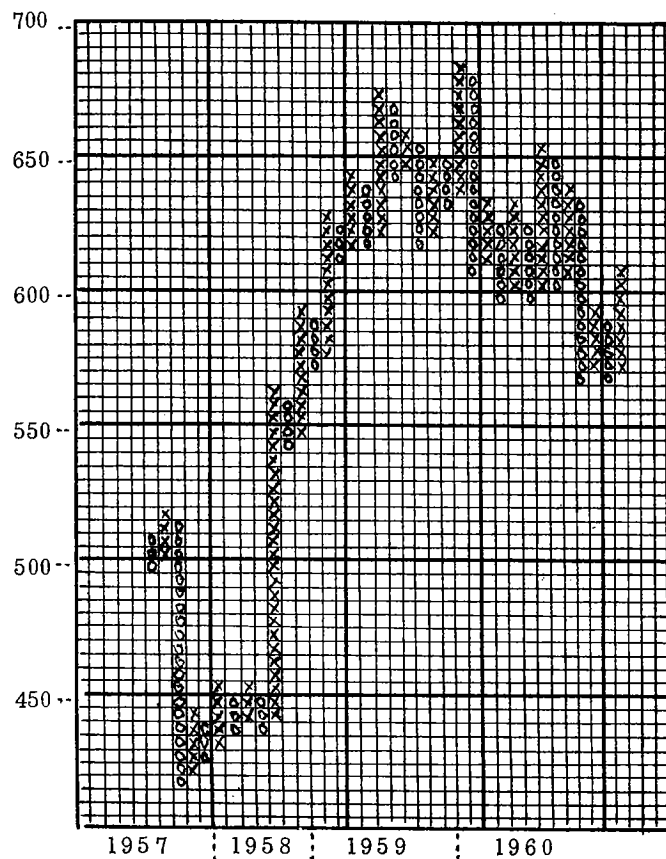
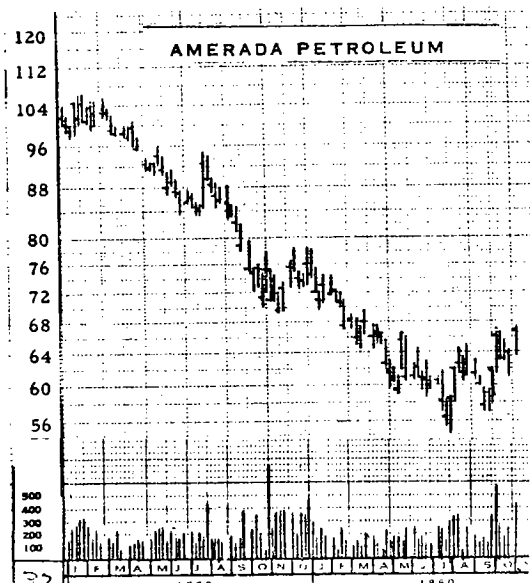
The P & F chart of the D-J Industrials shows all 5 point moves from 1957 to the present. As a "picture" it is most interesting and informative. From a Dow Theory standpoint the chart is useless because (1) it eliminates movements of less than 5 points (many of which are extremely important), and (2) it does not take the Rail Average into consideration (the concept of Rail confirmation is absolutely essential in any interpretation of trend). Condensed in a very small area, however, this chart does show the great advance of 1957-59 and the massive "congestion area" (a P & F term) of 1959-60.

Most P & F adherents work with trendlines, but I prefer using preceding highs and lows. An important principle of P & F charting is that the longer the sidewise movement or congestion area, the more important is the final "breakout" from that area. On the chart it appears that the entire 1959-60 price movement has become part of a huge "top" formation with successive downside penetration shattering first the 620 level (early 1960) and then the 595 level. As in Dow Theory, a trend is taken to continue on P & F charts until a definite counter-trend is established. On the accompanying chart the first important upside breakout would be a bettering of the preceding peak at 655. A reconfirmation of the bear market would come from a move into the 565 area.

STOCKS Pictured below is a weekly chart of Amerada Petroleum, one of the most popular trust holdings of the 1950's and for many years a top favorite on the "Favorite Fifty" list. As seen on the chart, during the past two years ARC has dropped from the 112 area to the 55 area. This represents a loss of 50% in one continuous swing. I have warned previously that any time a stock loses around half of its value on one swing (as was the case with ARC) that stock is overdue for a correction. Recently ARC has formed a rather impressive "head-and-shoulders" bottom formation, and the "breakout" came as the stock rose above 68 (assuming it can hold above that figure). Readers and potential buyers should remember, however, that (1) the move in ARC is taking place against the primary trend of the market, and (2) while conceivably the "correction" in ARC could be the start of an important and substantial advance, ARC had reached the point where a rally (and even a sizable one) was overdue.

Oils and aircrafts have been the recent favorites of the investment services. Perhaps coincidentally, these are two groups which have "taken it on the chin". I have included a weekly chart of Douglas, which shows a better than 50% drop in two years. A double bottom seems to have formed in Douglas at the 27 level. In general, everything I have said about Amerada can also apply to Douglas.

(Written Tuesday, November 22nd - 1 P.M.)



Charts courtesy of Traders Research
P.O. Box 6185, Lambert Airport, Mo.